NO. 83-547

IN THE

Supreme Court Of The United States

OCTOBER TERM, 1983

OHIO-SEALY MATTRESS
MANUFACTURING COMPANY, et al.,

Petitioners,

v.

SEALY, INCORPORATED,

Respondent.

REPLY BRIEF OF PETITIONER

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QUESTIONS PRESENTED

1. Is the contractual question of waiver of arbitration—as opposed to the statutory* question of "default in proceeding with such arbitration"—to be decided by the court or the arbitration panel? (There is a conflict between the Second Circuit and the Seventh Circuit on this issue.)

(Discussed *infra*, pp. 2-3)

2. Is it *per se* lawful for a trademark licensor to impose royalties on non-trademarked goods?

(Discussed *infra*, pp. 3-4)

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*Section 3 of the Federal Arbitration Act, 9 U.S.C. § 3.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

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STATEMENT OF THE CASE

Respondent has a counterclaim against Petitioners for royalties and late charges; Petitioners have both contractual and antitrust defenses to Respondent's counterclaim. Although Petitioners requested arbitration of the dispute beginning in early 1976, Respondent made no effort to recover until 1978, when it filed its counterclaim in pending antitrust litigation. Petitioners immediately raised Respondent's failure to arbitrate the contractual issues as a defense. The parties then engaged in extensive discovery on the antitrust issues, but no discovery was had regarding the contractual issues.

In late 1980 Petitioners moved for summary judgment on Respondent's counterclaim, alleging that Respondent's long-standing refusal to arbitrate constituted a complete defense; in the alternative Petitioners moved to stay the Respondent's counterclaim pursuant to Section 3 of the Federal Arbitration Act and to compel arbitration pursuant to Section 4 of the Federal Arbitration Act, 9 U.S.C. §§ 3, 4. Respondent then filed a cross motion for summary judgment, which Petitioner resisted on both contractual and antitrust grounds.

In late 1982, six and one-half years after Petitioner first requested arbitration, without having heard any testimony whatsoever, the trial court denied Petitioner's motion and granted Respondent's motion. In 1983 the Court of Appeals affirmed without discussing the antitrust issues.

REASONS FOR GRANTING THE WRIT

1. The Federal Arbitration Act By Its Terms Prohibits Federal Courts From Deciding Questions of "Waiver" And "Prejudice."

Section 4 of the Federal Arbitration Act, 9 U.S.C. § 4, is mandatory in its terms and contains no exception whatsoever; Section 3 provides an exception only where there is a "default in proceeding with . . . arbitration." 9 U.S.C. § 3. The trial court did not even mention these statutory provisions; the Court of Appeals ignored Section 4 and gave mere lip service to Section 3. Moreover, the Seventh Circuit's finding of waiver conflicts with two Second Circuit decisions on substantially identical facts. *Carcich* v. *Rederi A/B Nordie*, 389 F.2d 692 (2d Cir. 1968); *Almacenes Fernandez, S.A.* v. *Golodetz*, 148 F.2d 625 (2d Cir. 1945).

It makes no difference whether the decisions below were right or wrong as a matter of substantive contract law. The parties, by

their arbitration agreement, have committed such questions to the arbitration panel not the federal courts, and Congress has commanded that such a commitment be given absolute respect. *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, U.S. , 103 S.Ct. 927 (1983); *Prima Paint Corp.* v. *Flood & Conklin Mfg. Corp.*, 388 U.S. 395 (1967). The decisions below hark back to the days when the courts arrogated to themselves disputes which the parties had agreed to arbitrate.

If arbitration is to take its rightful place in this litigious society, the unqualified command of Congress must be given a greater respect than was afforded by the courts below. That is why the writ should be granted.

2. The Decisions Below In Effect Created A Rule Of "Per Se Legality" For Conditioning The Use Of Powerful Trademarks On The Payment Of Royalties On Non-Trademarked Products

The Court of Appeals did not discuss the trial court's decision enforcing the payment of royalties on non-trademarked goods. Respondent denies that this failure contravened *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100 (1969) on the ground that the trial court's decision was based solely upon the doctrine of collateral estoppel. (Respondent's Brief in Opposition, p. 8) The fact is, however, that the trial court went beyond the doctrine of collateral estoppel and decided the trademark misuse question against Petitioners without conducting an evidentiary hearing.

Respondent conceded that Petitioners' Sears Roebuck products were sold "quite independently of any sales program of [Respondent]," that Sears bedding wasn't part of Respondent's inspection program, and that Respondent had "nothing to do with the specifications for . . . Sears mattresses." (SA 12) Neverthe-

less, based on no evidence whatsoever, the trial court concluded that "it can hardly be said that some of those services [which Respondent had furnished seven years earlier] . . . do not benefit Ohio-Sealy in its ability to service an account like Sears with non-Sealy mark products." (A 39)

The trial court also based its decision on certain assumptions regarding the 1975 license agreement and presumed "negotiations" underlying that agreement. (A 39) Petitioner pointed out that these assumptions were incorrect (SA 7–9) but the trial court brushed the matter aside. (A 43)

Based on the foregoing treatment of the facts, and without conducting an evidentiary hearing, the trial court concluded:

> As the court noted in *Zenith, supra*, the assessment of royalties on total sales *may be* a "convenient method" of determining the value of a license. 395 U.S. at 137, 89 S.Ct. at 1584. That *appears to be* the situation in the case at bar. (Emphasis supplied.) (A 39)

By basing its decision on what "may be" and what "appears to be," the trial court in effect held that it was per se lawful for Respondent to collect royalties on non-trademarked products. By summarily affirming the correctness of that ruling the Court of Appeals failed to discharge its duty under *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100 (1968). Accordingly the Court should do what it did in *Zenith* and remand for a determination of the actual facts.

CONCLUSION

Despite almost eight years of litigation, not a single fact has been determined by means of an evidentiary hearing, either in arbitration or in court, yet a substantial judgment has been

entered against Petitioners. So that the perfunctory procedures employed by the courts below can be reviewed, the petition should be granted.

Respectfully submitted,

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SUPPLEMENTAL APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

OHIO-SEALY MATTRESS MFG. CO., *et. al.*, *Plaintiffs*, v. MORRIS A. KAPLAN, *et. al.*, *Defendants.*	No. 76 C 810 Judge Aspen

MEMORANDUM IN OPPOSITION TO SEALY, INC.'S MOTION FOR SUMMARY JUDGMENT ON ITS AMENDED COUNTERCLAIM

Plaintiffs ("Ohio-Sealy") oppose Sealy, Inc.'s motion for summary judgment on its amended counterclaim. In opposition to Sealy, Inc.'s motion, Ohio-Sealy hereby incorporates by reference the Affidavit of Thomas Smudz, filed January 9, 1981, and the Memorandum in Support of Ohio-Sealy's Motion to Stay, to Dismiss or for Summary Judgment re Sealy, Inc.'s Amended Counterclaim, filed June 12, 1981. In addition Ohio-Sealy offers the following:

Summary judgment may be entered only when "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Rule 56(c), Federal Rules of Civil Procedure. *See Poller* v. *Columbia Broadcasting System, Inc.*, 368 U.S. 464 (1962). As this Court observed recently, "it is not within the province of the Court to resolve issues of disputed fact in a trial by affidavit." *Adams Laboratories, Inc.* v. *Jacobs Engineering Co.*, 486 F.Supp. 383, 385 (N.D. Ill. 1980).

The burden of establishing the absence of genuine issues of material fact rests on the moving party, here Sealy, Inc., *Wilson* v. *Health & Hospital Corp.*, 620 F.2d 1201, 1215 (7th Cir. 1980), and all doubts must be resolved against it. *Local 194* v. *Standard Brands*, 85 F.R.D. 599, 602 n.5 (N.D. Ill. 1979). Moreover, all inferences from the undisputed facts must be drawn in favor of the non-movant, here Ohio-Sealy, and this Court is "obliged to review the entire record in the light most favorable to the opponent of the movant." *Cedillo* v. *International Association of Bridge & Structural Iron Workers*, 603 F.2d 7, 11 (7th Cir. 1979).

This memorandum, as well as the affidavit of Thomas L. Smudz, demonstrates that Sealy, Inc. has utterly failed to satisfy its burden of establishing that there are no genuine issues of material fact and that it is entitled to judgment as a matter of law. Indeed, the *only* evidence which it offers in support of its motion is an affidavit which fails to comply with Rule 56(e) and which is incorrect in fact. Accordingly, Sealy, Inc.'s motion for summary judgment on its counterclaim must be denied.

The Affidavit Of Michael I. Kaplan Fails To Comply With Rule 56(e) And Therefore It Must Be Stricken

Besides a copy of the Sealy License Contract, the only "evidence" which Sealy, Inc. uses to support its motion for summary judgment is the affidavit of Michael I. Kaplan. This affidavit is wholly defective because it does not even purport to measure up to the standards of Rule 56(e) of the Federal Rules of Civil Procedure.

Rule 56(e) provides in pertinent part:

> Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an

affidavit shall be attached thereto or served therewith. (Emphasis added)

An affidavit may be disregarded if it contains conclusions of law or of ultimate fact. *Cohen* v. *Ayers*, 449 F.Supp 298, 321 (N.D. Ill. 1978), *aff'd*, 596 F.2d 733 (7th Cir. 1979). Moreover, an affidavit can be considered "only if the information contained therein would be admissible at trial. "*Midland Engineering Co.* v. *John A. Hall Construction Co.*, 398 F.Supp. 981, 989 (N.D. Ind. 1975). These requirements are mandatory, and an affidavit which does not meet these standards must be stricken. *Ashwell & Co.* v. *Transamerica Insurance Co.*, 407 F.2d 762 (7th Cir. 1969); *American Security Co.* v. *Hamilton Glass Co.*, 254 F.2d 889 (7th Cir. 1958).

Mr. Kaplan's affidavit is nothing but a hodgepodge of legal conclusions and statements of ultimate fact which does not even begin to comply with Rule 56(e). None of the documents attached to the affidavit is a business record, and they would be admissible at trial only as a summary of something established by other admissible exhibits. Moreover, there is no showing that Mr. Kaplan has personal knowledge of or is competent to testify to the matters set forth in his affidavit. In fact, the numerous incorrect statements contained in his affidavit[1] strongly suggest that he does not have personal knowledge of the matters set forth therein.

Because Mr. Kaplan's affidavit does not meet the requirements of Rule 56(e), it should be stricken and Sealy, Inc.'s motion for summary judgment should be denied. *See Antonio* v. *O.W. Barnes*, 464 F.2d 584, 585 (4th Cir. 1972) (per curiam) ("The absence of an affirmative showing of personal knowledge of specific facts vitiates the sufficiency of the affidavits and, accordingly, summary disposition based thereon was improper.")

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[1]See pp. 13–15, Memorandum in Opposition to Sealy, Inc.'s Motion for Summary Judgment on its First Counterclaim, filed in the *Duncan* case on June 12, 1981.

CONCLUSION

For the reasons expressed in this memorandum and the memorandum that has been incorporated by reference, Sealy Inc.'s motion for summary judgment should be denied.

Respectfully submitted,

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

OHIO-SEALY MATTRESS MFG. CO., *et. al.*, *Plaintiffs*, v. LOUIS C. DUNCAN, *et al.*, *Defendants*.	No. 79 C 2741 Judge Aspen

MEMORANDUM IN OPPOSITION TO SEALY, INC.'S MOTION FOR SUMMARY JUDGMENT ON ITS FIRST COUNTERCLAIM FOR UNPAID ROYALTIES AND LATE CHARGES

Plaintiffs Ohio-Sealy oppose Sealy, Inc.'s motion for summary judgment. In opposition to Sealy, Inc.'s motion, Ohio-Sealy hereby incorporates by reference the Affidavit of Thomas Smudz, filed in the *Kaplan* case on January 9, 1981, the Memorandum in Support of Ohio-Sealy's Motion to Stay, to Dismiss or for Summary Judgment re Sealy, Inc.'s Amended Counterclaim, filed in the *Kaplan* case on June 12, 1981, and the Memorandum in Opposition to Sealy, Inc.'s Motion for Summary Judgment on its Amended Counterclaim, filed in the *Kaplan* case June 12, 1981. In addition, Ohio-Sealy presents the following:

1. Sealy, Inc. Has Not Been Granted Leave to File The First Counterclaim

Defendant Sealy, Inc. has moved for leave to file its first counterclaim in this case, but the Court has not yet granted leave. It is clearly premature for Sealy, Inc. to move for summary judgment on a counterclaim which has not yet been filed. Accordingly, the Court should not entertain the summary judgment motion at this time.

2. Sealy, Inc. May Not Seek Late Charges in this Case for Royalties Which Ohio-Sealy Refused to Pay Prior to April 24, 1978

This Court has held that Sealy, Inc.'s claimed damages in the *Kaplan* case must be limited to those prior to April 24, 1978, just as Ohio-Sealy has been limited. Sealy, Inc., purportedly complying with the Court's ruling, has split its previously filed counterclaim in two: alleged damages accruing prior to April 24, 1978 are now sought in the *Kaplan* case; those accruing after April 24, 1978 are sought in this case.

Defendant's division of its counterclaim, however, is inconsistent with the Court's August 1, 1980 order, in which the Court held that Ohio-Sealy was required, in No. 71 C 1243, to seek all damages, both past and future, that resulted from pre-verdict acts. Under the logic of the August 1, 1980 decision, defendant must seek in the *Kaplan* case all damages resulting from acts that took place prior to April 24, 1978. Defendant, however, has included in its counterclaim in this case late charges allegedly owing due to Ohio-Sealy's failure to pay royalties allegedly due prior to April 24, 1978.

As the Court stated in its August 1, 1980 opinion (footnote 5):

> **It is clear that Ohio may sue only for those damages which occur as a result of some post-verdict act. The mere allegation that the post-verdict acts were but a continuation of the pre-verdict conspiracy is insufficient to entitle Ohio to damages in addition to those which it has received to remedy defendant's pre-verdict conduct.**

Although plaintiffs disagree with the Court's August 1, 1980 decision, the logic of that decision requires defendant Sealy, Inc. to seek all lates charges resulting from pre-April 24, 1978 claimed royalties in the *Kaplan* case. Defendant may not seek those late charges in this case.

3. Sealy, Inc. Is Not Entitled To Collect Royalties On Sears Roebuck Bedding

a. Sealy, Inc. Never Approved Ohio-Sealy's Manufacture of Sears Bedding and Therefore It Cannot, Under the License Contract, Collect Royalties on Such Bedding

Article VII of the License Contract provides that royalties are payable on "Sealy Products." (PTX 1003, 1 Jt. App. 644) Article I:A defines "Sealy Products" as follows:

> "Sealy products" means such of the following as, with Sealy's approval, bear a Sealy Mark, or as may be manufactured according to specifications issued by Sealy (whether or not they bear a Sealy Mark), or as are produced, *with Sealy's approval*, in Licensee's plant at a location enumerated in Section II . . . . (PTX 1003, 1 Jt. App. 696) (emphasis added.)

Unlike the 1971 License Contract, which defined "Sealy Products" to include "*all* products manufactured or sold by the Licensee" (PTX 325, 1 Jt. App. 387) (emphasis added), the 1975 Contract provides that royalties are to be paid on only three types of sleep equipment: (1) bedding bearing a Sealy mark; (2) bedding manufactured according to Sealy specifications; and (3) "non-Sealy" bedding (*i.e.*, not bearing a Sealy mark for which specifications were not issued by Sealy, Inc.) which is "produced with Sealy's approval." As a result of the amendment to the 1975 Contract, a licensee does not have to pay royalties on non-Sealy bedding which is *not* "produced with Sealy's approval."

It is obvious that Sealy, Inc.'s effort to collect royalties of this sort is directed solely against Ohio-Sealy. Truly "approved" (non-Sears) non-Sealy bedding constitutes only a small portion of the sales of "Sealy Products" in the United States. In 1977, for example, sales of such bedding manufactured in Sealy plants (other than Ohio-Sealy) were only $631,000—less than one-half of one percent of the total sales of Sealy products in that year.

(Doc. No. 48) Indeed, the sales of "approved" non-Sealy bedding is so small that in 1978 Sealy, Inc.'s board of directors approved an amendment to the License Contract eliminating royalties on such bedding. (PTX 1067) This amendment never took effect, however, as it was withdrawn before the stockholders had an opportunity to act on it.

Ohio-Sealy began manufacturing bedding for Sears-Roebuck in 1977. This business is substantial (over $7 million in 1977 alone) and accounts for over 90% of the non-Sealy bedding manufactured by Ohio-Sealy. (*See* Doc. Nos. 69-75) Sealy, Inc. in its counterclaim contends that it is entitled to collect a royalty exceeding 4% of the net sales of the Sears bedding manufactured by Ohio-Sealy—*even though it contributes nothing in the way of sales assistance or specification of such bedding.*

Whether Sealy, Inc. can collect royalties on Sears bedding depends upon whether such bedding is a "Sealy Product" as defined in Article I:A. It is undisputed that the Sears bedding manufactured by Ohio-Sealy does not bear a Sealy mark and is not manufactured according to Sealy specifications. The question, therefore, is whether the bedding is manufactured and sold "with Sealy's approval."

The evidence clearly establishes that Ohio-Sealy's manufacture of Sears bedding was not done with Sealy, Inc.'s approval. Ohio-Sealy never sought such approval from Sealy, Inc. To the contrary, although it consistently reported its Sealy-label sales to Sealy, Inc. each year, Ohio-Sealy *never* reported its sales of Sears bedding. (*See* Doc. Nos. 51-68) And, although Sealy, Inc. "was at all times fully aware of Ohio's manufacture of Sears bedding in its licensed plants" (Sealy, Inc. Memo at 16), Sealy, Inc., never asked Ohio-Sealy why it was not reporting its Sears bedding, much less why it was not paying royalties on such bedding. In fact, the first time Sealy, Inc. claimed royalties on Sears bedding was January 30, 1979—two years after Ohio-Sealy began manufacturing it. (Doc. No. 69)

Sealy, Inc. has argued that it "approved" Ohio-Sealy's manufacture of Sears bedding because in October, 1977 it approved Ohio-Sealy's request to build a new plant in Atlanta (Doc. Nos. 26 & 28) and because in November, 1978 it clarified the Policies and Procedures Manual to allow Ohio-Sealy to deliver its Sears bedding in "Sealy" trucks. (Doc. Nos. 37-38) It is difficult to see how the approval of a new *plant* in Atlanta (where Sears bedding is no longer made) constituted approval of Ohio-Sealy's manufacture of Sears *bedding*, say for instance, at the Medina, Ohio plant. Similarly, it is difficult to see how the approval of using certain delivery *trucks* constituted approval of the manufacture of the *bedding* to be delivered, particularly in view of the fact that the same bedding is also delivered in Sears trucks. It is readily apparent that it is Sealy, Inc. which is "grasping at straws" when it argues that it approved the Sears bedding.

Stripped of these two collateral events, Sealy, Inc.'s argument is that "approval" can be equated with "acquiescence," *i.e.*, it approved the manufacture of Sears bedding because it was aware of the practice and did not inform Ohio-Sealy that it was disapproved. Such a construction is inconsistent with and renders meaningless the 1975 amendment to the License Contract which added the clause "or as are produced, with Sealy's approval, in Licensee's plant."[2] Sealy, Inc. is not, therefore, entitled to collect royalties on Sears bedding under the License Contract.

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[2]Sealy, Inc. has long been aware of Ohio-Sealy's position that royalties are not due on bedding which is manufactured and sold without Sealy, Inc.'s assistance. On July 20, 1973, after Sealy, Inc. had abortively adopted the definition of "Sealy Products" which was ultimately incorporated in the 1975 Contract, counsel for plaintiffs wrote counsel for defendants:

> We don't think we need National Sealy's permission to do this, but we do want National Sealy to know what we are doing.
>
> Ohio-Sealy proposes to make a no-name [Medallion] mattress in its plants.

(Footnote continued on next page.)

b. The Collection of Royalties on Sears Bedding Would Constitute a *Per Se* Violation of the Antitrust Laws

Even if Sealy, Inc. did approve Ohio-Sealy's manufacture of Sears bedding within the meaning of the License Contract, Sealy, Inc. is still not entitled to collect royalties on such bedding. It is unlawful to require the payment of royalties on products not bearing a trademark or tradename, just as it is unlawful to require the payment of royalties on products not within the scope of a patent. In *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100 (1969), the Supreme Court, in holding that conditioning the grant of a license on the payment of royalties on non-patented products was a misuse of the patent, declared:

> And just as the patent's leverage may not be used to extract from the licensee a commitment to purchase, use, or sell other products according to the desires of the patentee, neither can that leverage be used to garner as royalties a percentage share of the licensee's receipts from sales of other products; in either case, the patentee seeks to extend the monopoly of his patent to derive a benefit not attributable to use of the patent's teachings. *Id.* at 136.

Like the licensor in the *Zenith* case, Sealy, Inc., by attempting to collect royalties on Sears bedding, seeks to extend the monopoly of its trademark to derive a benefit not attributable to its trademark. This is improper and Sealy, Inc. should be precluded from obtaining royalties on such bedding. *See, e.g., Beckman Instruments, Inc.* v. *Technical Development Corp., 433 F.2d 55 (7th Cir. 1970) cert. denied,* 401 U.S. 976 (1971); *Chandler* v. *Stern Dental Laboratory Co.*, 335 F. Supp. 580 (S.D. Tex. 1971); *Glen Mfg. Co.* v. *Perfect Fit Industries, Inc.*, 324 F. Supp. 1133 (S.D.N.Y. 1971).

(Footnote continued from previous page.)

It is possible that Ohio-Sealy might use "Duragard" foundation parts in these mattresses, but it would not use the Duragard name.

Sealy, Inc., however, has argued that Ohio-Sealy is barred from raising the defense of trademark misuse "both on the ground of collateral estoppel and as a matter of stare decisis" as a result of the ruling in *Ohio-Sealy* v. *Sealy, Inc.*, 585 F.2d 821, 838-39 (7th Cir. 1978), *cert. denied*, 440 U.S. 930 (1979). (Sealy, Inc. Memo at 2-3) Rather than barring Ohio-Sealy from using this ground as a defense, this ruling mandates that summary judgment be entered in favor of Ohio-Sealy on this issue.

In *Ohio-Sealy* v. *Sealy, Inc.*, the Seventh Circuit held that Sealy, Inc. could collect royalties on Montgomery Ward bedding because Sealy, Inc. performed substantial services to the licensees participating in the national accounts program in the manufacture and sale of such bedding. The Court held:

> *Sealy obtained royalties* not merely for the bare license of its trademark, but also *for significant advertising, technical, and other services.* To argue that none of the services provided in the package could have benefited the licensed plants other than in the production and sale of Sealy-brand products is to far outrun the facts in the record. It is significant, also, to recall that over 97% of the royalties Ohio paid were for sales to Ward's. *Without the organizational and management services of Sealy, and the specifications developed between Ward's and Sealy, such sales would never have been made*, as Ohio's experience since withdrawing from the national accounts program so amply demonstrates. 585 F.2d at 839 (emphasis added).

Unlike the factual setting in *Ohio-Sealy* v. *Sealy, Inc.*, Sealy, Inc. contributes *nothing* in the manufacture or sale of Sears bedding (which unlike the Wards bedding is not part of the national accounts program). Sealy, Inc. does *not* provide any sales assistance for such bedding; it does *not* provide the specifications for such bedding; it does *not* provide any assistance in the manufacture of such bedding; and it does *not* provide any quality control services.

Alvin R. Klancnik, Sealy, Inc.'s vice-president of manufacturing-services, testified at an arbitration proceeding on May 15, 1980:

> Q. And Ohio-Sealy sells mattresses to Sears Roebuck quite independently of any sales program of Sealy, Incorporated?
>
> A. That is my understanding.
>
> Q. Under your interpretation, as an employee of Sealy, Incorporated, you would have a right to go to Sears, Roebuck and inspect the mattresses which Ohio-Sealy made for Sears, Roebuck, isn't that correct?
>
> A. [N]o, [Sears bedding] isn't part of an inspection program.[3]
>
> * * *
>
> Q. Okay. Sealy, Incorporated has nothing to do with the specifications for those Sears mattresses, isn't that correct?
>
> A. That is correct. (Transcript at 53-54; 175)

Although contributing nothing to the manufacture and sales of Sears bedding, Sealy, Inc. nonetheless claims it is entitled to collect substantial royalties from Ohio-Sealy on this bedding. This is impermissible and constitutes a misuse of the trademark.

c. The Collection of Royalties on Sears Bedding Is Unreasonable and Therefore Violative of the Antitrust Laws

Sealy, Inc.'s collection of royalties on Sears bedding is also unlawful under the Rule of Reason and therefore violative of Section 1 of the Sherman Act. A restraint is unreasonable whenever it has "an anticompetitive effect which has no countervailing

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[3] If Sears bedding were "Sealy Products," it would have to conform to Sealy specifications and be part of the inspection program which Mr. Klancnik administers. *See* Articles IV:D and V:E of the License Contract. (PTX 1003; 1 Jt. App. 642)

procompetitive benefit." *United States* v. *Realty Multi-List, Inc.*, 629 F.2d 1351, 1375 (5th Cir. 1980). Such a restraint is condemned on its face, "without proof of past effect," *id.* at 1375, and "without elaborate inquiry into [the restraint's] actual effects in the market." *Id.* at 1360.

The anticompetitive effect of collecting royalties on interbrand competition is plain and undisputed: Ohio-Sealy would be required to pay a substantial surcharge on its Sears bedding thereby placing it at a severe competitive disadvantage *vis-a-vis* other bedding manufacturers which compete with Ohio-Sealy for the Sears, Roebuck business, *e.g.*, Simmons. One of Sealy, Inc.'s current directors has admitted that "anything which adds to the cost of Ohio-Sealy in manufacturing mattresses for sale to Sears inhibits its ability to compete." (JHL dep. at 141)

Though having admittedly severe anticompetitive effects, *the collection of royalties on Sears bedding has absolutely no countervailing procompetitive benefits.* The only one to benefit from this practice is Sealy, Inc.—Ohio-Sealy's competitor—which receives substantial sums of money for providing *no services whatever.* Accordingly, the practice is unreasonable on its face and must be condemned.

4. The Royalties At Issue Were Not Computed as Prescribed By Article VII

Contrary to Mr. Kaplan's sworn statement, the royalties at issue were not calculated "in the manner prescribed by Article VII of the license contract" (Kaplan Aff. at ¶ 7), and consequently, Schedule VII does not show "the total amount of unpaid royalties and late charges due as of August 31, 1980 from each of said licenses." (*Id.* at ¶ 6) To understand the error of Mr. Kaplan's statements requires an understanding of the method by which royalties are computed.

Article VII:B(4) sets forth the method of computing royalties as follows:

> [T]he Royalty shall be Licensee's Effective Royalty Rate multiplied by the Royalty Sales Base, plus one-half of such Effective Royalty Rate multiplied by the amount of Net Sales of sleep equipment in excess of the Royalty Sales Base. (PTX 1003, 1 Jt. App. 645)

The key term for purposes of this discussion is the "Royalty Sales Base" which is defined in Article VII:B(1) as "two-thirds (⅔) of the prior year's *aggregate Net Sales* of sleep equipment in the United States *by Sealy and all Sealy Licensees*, divided by one hundred (100) and multiplied by the units of Buying Power Index . . . for the Licensee's Area of Primary Responsibility." (PTX 1003, 1 Jt. App. 644) (emphasis added.) A licensee's royalty sales base is important to a licensee because as set forth in Article VII:B(4) above, a licensee need only pay Sealy, Inc. one-half its effective royalty rate on sales in excess of that base figure.

Each year licensees are required to report their net sales "subject to royalty" to Sealy, Inc. (Policies & Procedures Manual § VII:1 at 1, hereafter "Manual") Sealy, Inc. adds the sales reported by each licensee and reports the aggregate sum in its annual "Fixed Royalty Report." For example, total Sealy sales subject to royalty in 1977 totalled $204,097,489. (Doc. No. 49) A licensee's royalty sales base is determined by taking two-thirds of the aggregate net sales, $136,064,933 ($204,097,489 × ⅔), dividing by one hundred, $13,606,499, and multiplied by a licensee's BPI. For example, Ohio-Sealy's Medina plant's BPI for 1978 was 4.696 and its royalty sales base was therefore $6,433,561 ($13,606,499 × 4.696). Thus, Ohio-Sealy was to pay a full royalty on its first $6,433,561 of sales and one-half the royalty rate for all sales in excess of $6,433,561.

Sealy, Inc. performs a "royalty audit" of each licensee at least once every three years to determine the accuracy of the licensee's annual reports of net sales. (Manual § VII:7 at 7) In 1980, for example, Sealy, Inc. audited Medina for the 1978 sales year and

found that Medina had not reported $2,841,814 in sales of Sears bedding. (Ohio-Sealy has never reported such sales because they are not sales "subject to royalties" for the reasons stated above.[4] Instead of recalculating the royalty sales base by including Ohio-Sealy's sales to Sears (approximately $8 million in 1978 alone) to the total Sealy sales for that year and then recomputing the royalty sales base, Sealy, Inc. took the percentage of Ohio-Sealy's previous sales base to its total net sales and arbitrarily applied that percentage to the Sears bedding. Sealy, Inc.'s method thus violates Article VII:B(1) because it does not consider "the prior year's *aggregate Net Sales* of sleep equipment in the United States by Sealy and all Sealy Licenses." The net effect of Sealy, Inc.'s noncompliance with Article VII:B(1) is that Ohio-Sealy is improperly assessed hundreds of thousands of dollars.

CONCLUSION

For the reasons expressed in this memorandum and the memoranda incorporated by reference, defendant's motion for summary judgment should be denied.

Respectfully submitted,

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[4]Because these sales were never reported, Mr. Kaplan's sworn statement that "[t]he amounts of royalties billed to Ohio have been determined from . . . reports submitted by Ohio" is erroneous. (Kaplan Aff. at ¶7)

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

OHIO-SEALY MATTRESS MFG. CO., *et. al.*, *Plaintiffs*, v. MORRIS A. KAPLAN, *et. al.*, *Defendants*.	No. 76 C 810 Judge Aspen

RULE 54(b) MOTION

OHIO-SEALY, by its attorneys, pursuant to Rule 54(b), Federal Rules of Civil Procedure, moves that the Court reconsider portions of its July 20, 1982 decision, and, to the extent appropriate, enter a final, appealable decision with respect to parts I(B) and II of that decision. In support of its motion Ohio-Sealy states:

1. On July 20, 1982, this Court entered a decision which: (a) denied Sealy's motion for summary judgment with respect to the exclusive manufacturing territories; (b) granted Sealy's motion for summary judgment with respect to Sealy's acquisitions of its Des Moines and Reading licensees; and (c) granted Sealy's motion for summary judgment with respect to its counterclaim for late charges.

2. On page 6 of its Memorandum Opinion and Order, this Court says that "Judge Parsons mentioned Sealy's post-verdict acquisitions of its Portland *and San Diego* licensees late in his opinion . . ." (Emphasis added.) Counsel is unable to find any such statement by Judge Parsons, and the fact is that Sealy never had a licensee in San Diego and never acquired a San Diego mattress plant.

3. In part I(B) of its decision, this Court cites a great many decisions but does not mention the Supreme Court's very recent *McCready* decision, a copy of which is attached.

4. At page 22 of its decision, this Court twice states that Ohio-Sealy "consistently" stood ready to resolve the royalty dispute by litigation as well as arbitration. On the same page, this Court states that Ohio-Sealy's "first" objection to resolution by litigation came during the briefing of the instant motion. The record in this case shows otherwise. Sealy filed its Counterclaim in 1978, and Ohio-Sealy immediately raised the arbitration issues in its Reply.

5. At page 26 of its opinion, the Court bases its decision upon "the undisputed evidence in the record together with the reasonable inferences to be drawn therefrom . . ." But the Court, in a jury case, cannot grant summary judgment based on the drawing of inferences, and there is documentary evidence not mentioned by the Court supporting contrary inferences.

6. At the top of page 29, the Court assumes that there were "negotiations" regarding the 1975 license agreement, but there is no allegation or evidence to that effect, and the undisputed evidence of record shows that there were none. Ohio-Sealy resisted the 1975 agreement by arbitration and lost.

7. The royalty provisions of the 1975 license agreement did differ from those of the agreement referred to in the 1978 Court of Appeals decision, and, more importantly, the definition of "Sealy Products" was changed by the 1975 agreement. These facts ought to be undisputed, and if they are not, they are clearly established in the record.

8. On page 30 this Court in one sentence decides—against Ohio-Sealy—a question which has been the subject of dispute between the parties for 20 years. Indeed, this issue was the subject of a lengthy arbitration proceeding 11 years ago, but that proceeding was settled on a non-precedential basis before the award was entered. To decide that issue without even mentioning the contractual provisions involved, without citing any of the documents, and without hearing a single word of testimony, is to deny Ohio-Sealy its day in court as well as its contractual right to arbitration. Moreover, this Court cites no evidence supporting even an inference that

Ohio-Sealy waived its right to arbitrate this particular issue, which did not arise until a royalty audit had been conducted.

9. The Court's opinion does not mention Ohio-Sealy's counter-affidavit, which on its face raises a genuine issue of material fact.

10. Ohio-Sealy will appeal the Court's denial of a stay pending arbitration, and it would be helpful if the closely related issues raised by the Court's opinion could be reviewed on appeal at the same time.

WHEREFORE Ohio-Sealy prays that the Court reconsider said portions of its July 20 decision and enter a final, appealable order pursuant to Rule 54(b).

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CERTIFICATE OF SERVICE

Frederic F. Brace, Jr., P.C., one of the attorneys for plaintiffs, certifies that he caused a copy of the foregoing Rule 54(b) Motion to be served upon the defense counsel of record on the attached service list, by depositing it in the United States mail, postage prepaid, on this 23rd day of July, 1982.

Frederic F. Brace, Jr., P.C.